

IT 02-12

Tax Type: Income Tax

Issue: Reasonable Cause on Application of Penalties

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

ABC INTERNATIONAL, INC.,)	Docket No.	00-IT-0000
Taxpayer)	FEIN	00-0000000
v.)	Tax Year	1998
THE DEPARTMENT OF REVENUE)	John E. White	
OF THE STATE OF ILLINOIS)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Fred Marcus, Horwood Marcus & Berk, appeared for ABC International, Inc.; Deborah Mayer, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis: This matter involves ABC International, Inc.'s ("ABC") protest of the Illinois Department of Revenue's ("Department") denial of ABC's claim for refund of underpayment penalties assessed regarding ABC's estimated tax installments for the first and second quarters of 1998, and for refund of a late payment penalty assessed regarding ABC's third quarter estimated tax installment for 1998.

The issue is whether the penalties should be abated for reasonable cause, that is, because ABC exercised ordinary business care and prudence when calculating the estimated tax installments for the first two quarters of 1998, and when attempting to timely file its estimated tax installment for the third quarter of that year. At hearing, the parties offered documents by stipulation, and ABC offered the testimony of four witnesses. After considering the evidence offered at hearing, I recommend that the matter be resolved in favor of the Department, and that the denial previously issued be finalized.

Statement of Facts:

1. ABC, through subsidiaries and affiliated companies, is a leading publisher of English-language newspapers in the United States, the United Kingdom, Canada and Israel. Stipulation Exhibit ("Stip.

- Ex.”) 15 (copy of ABC’s Form 10-K to the Securities and Exchange Commission for fiscal year 1997), p. 1.¹ ABC’s business address is in Anywhere, Illinois. *E.g.*, Stip. Ex. 4 (copy of ABC’s 1997 Illinois income tax return, with accompanying forms, schedules, etc.), p. 1.
2. ABC has 88 domestic and 25 foreign subsidiaries. Hearing Transcript (“Tr.”) pp. 83-84 (testimony of John Doe (“Doe”), one of ABC’s outside accountants).
 3. ABC’s United States operations consist of its Anywhere Group and its Community Group. Stip. Ex. 15, p. 1. The Anywhere Group is led by the Anywhere Newspaper, and the Community Group consists of 324 newspapers and related publications. *Id.*
 4. ABC files consolidated federal income tax returns and combined Illinois income and replacement tax returns. Stip. Ex. 4, p. 1; Tr. p. 83 (Doe).
 5. ABC requested an extension for filing its 1997 federal income tax return and, thereby, automatically received an extension for filing its 1997 Illinois tax return. Stip. Ex. 4, p. 2 (copy of ABC’s Federal form 7004 (Application for Automatic Extension of Time to File Corporation Income Tax Return) for 1997, dated 3/12/98); 35 **ILCS** 5/505(b); Tr. p. 92 (Doe).
 6. ABC’s 1997 Illinois income tax return was dated 10/14/98 and was received by the Department on or about 10/30/98. Stip. Ex. 4, p. 1 (date stamp on the top right hand corner of the return).
 7. ABC reported a net loss on its 1997 Illinois return, and therefore, owed no Illinois income and/or replacement tax regarding that year. Stip. Ex. 4, p. 1 (Part I, lines 1, 7 & Part II, lines 1-2).
 8. Because of payment(s) of tax made in and prior to 1997, ABC had available approximately \$267,000 of Illinois tax to use against any of its potential 1998 Illinois income or replacement tax liability. Stip. Ex. 4, p. 1 (Part I, line 4a, Part II, line 6); Tr. pp. 97-98 (Doe).
 9. For 1998, ABC reported an Illinois income and replacement tax liability of over 5.1 million (\$5,100,000) dollars. Stip. Ex. 3, p. 2.

¹ This citation to page 1 of ABC’s 1997 Form 10-K uses the page numbers of the exhibit itself, and thus does not count the cover page and the table of contents page.

10. On February 12, 2000, the Department issued a Form BTR-76 (Taxpayer Notification) to ABC regarding its 1998 Illinois return, on which the Department notified ABC that the return contained math (i.e., computational) errors, and that it was being assessed a § 804 penalty. Stip. Ex. 5 (copy of the math error and penalty notice is attached as an exhibit to ABC's amended Illinois income tax return for 1998), pp. 7-8.
11. ABC does not dispute that it underpaid its first and second quarter Illinois estimated tax payments for 1998. Taxpayer's Brief, p. 2 ("... the issue is ... whether ABC's underpayment of estimated tax was due to reasonable cause.").

Facts Regarding ABC's Calculation of Its Illinois Estimated Tax Payments For The First Through Third Quarters of 1998

12. ABC used the services of Accounting Firm, a regional certified public accounting firm. Tr. pp. 77, 82 (Doe). During the period at issue, Doe was a partner at Accounting Firm. Tr. p. 77 (Doe).
13. Since 1987, Doe personally: calculated ABC's federal and state income tax returns; calculated its federal and state estimated quarterly tax amounts; and consulted with ABC on accounting and tax issues as needed. Tr. pp. 82-83, 85 (Doe). While Doe calculated ABC's federal and state income tax returns for 1998, More Accounting another accounting firm, actually signed those returns as the preparer. Stip. Ex. 4, p.1; Tr. p. 103 (Doe).
14. Doe calculated the amounts of ABC's quarterly estimated Illinois tax payments for each quarter of 1998. Stip. Exs. 13-14 (copies of Doe's workpapers completed when calculating the amount of ABC's second and third quarter Illinois estimated tax payments, and copies of documents he used when completing those workpapers); Tr. pp. 82-83, 85 (Doe).
15. Doe calculated the amount of ABC's first quarter estimated Illinois tax payment for 1998 at approximately the same time — the latter half of February 1998 — that he calculated whether ABC should make a payment of federal and/or state taxes with its federal extension application for its 1997 return, which was due on 3/15/98. Tr. pp. 94-100, 136, 144 (Doe).

16. Doe reviewed financial accounting — or “book” — information obtained from three separate sources when calculating whether ABC would need to make a payment when it filed its application for an extension for filing its federal and state tax returns. Tr. pp. 94-95 (Doe). He reviewed the same type of information when calculating ABC’s quarterly estimated Illinois tax payments. Tr. pp. 109, 120-21 (Doe).
17. The financial information Doe used to make his calculations included: documents regarding ABC’s Community group received from Ron Doe, an officer of a ABC subsidiary; documents regarding ABC’s Anywhere group received from Joe Blow, another outside accountant used by ABC; and verbal information regarding ABC’s international group received from someone at MORE ACCOUNTING, another accounting firm ABC used. Stip. Exs. 13-14; Tr. pp. 94-100, 120-27 (Doe).
18. With regard to ABC’s request for extension to file its 1997 federal and Illinois income tax returns, filed on or about 3/15/98, Doe determined that an extension payment was not due because ABC had overpaid its Illinois tax for 1996 and 1997. Tr. pp. 87, 96-100 (Doe).
19. During the first two quarters of 1998, Doe did not attempt to measure ABC’s quarterly estimated tax payments using the definition of “estimated tax” set forth in § 803(b) of the Illinois Income Tax Act (“IITA”). 35 ILCS 5/803(b). Rather, Doe based his calculation of ABC’s estimated tax payments on his estimate of ABC’s 1997 tax liability, as described in § 804(c)(1)(ii) of the IITA. Tr. pp. 86-89, 94-100, 109-112 (Doe).
20. Doe determined that an extension payment need not be made because the \$267,000 credit available to be used against ABC’s 1998 Illinois estimated tax was greater than 25% of the amount of what Doe believed ABC’s 1997 Illinois tax liability would be. Tr. pp. 87, 95-96, 98-100, 104 (Doe).
21. At the time Doe determined that ABC should not make an estimated Illinois tax payment for the first quarter of 1998, he estimated that ABC’s 1997 Illinois income tax liability would be approximately \$240,000. Tr. pp. 96-97, 100 (Doe).

22. For the second quarterly estimated payment for 1998, Doe used the same information he received from Ron Doe, Blow and MORE ACCOUNTING when calculating whether ABC should make an estimated payment with its extension. Tr. pp. 105-106, 109, 137-38 (Doe); Stip. Ex. 13.
23. When Doe was calculating ABC's second quarter 1998 estimated tax payment, he estimated that ABC's 1998 Illinois income tax liability would be approximately 2.3 (\$2,300,000) million dollars. Tr. p. 106 (Doe). At the same time, Hass maintained his estimate that ABC's 1997 Illinois tax liability would remain at approximately \$240,000. Tr. pp. 106-109 (Doe). Thus, Doe notified ABC that it should make an estimated tax payment of \$62,000 for the second quarter of 1998, because that was approximately 25% of \$240,000. Tr. p. 106 (Doe).
24. By the time Doe calculated ABC's third quarter Illinois estimated tax tax payment, he had completed his calculations of ABC's 1997 federal tax return and its 1997 Illinois return. Tr. pp. 109-112 (Doe). Since ABC's Illinois return showed a loss, Doe knew that ABC could not avoid a penalty by calculating its 1998 estimated tax payments as a percentage of its 1997 Illinois tax liability. Tr. p. 110 (Doe).
25. Doe attributed the change from his earlier calculations of ABC's Illinois net income to his final calculation of that amount to changes reported on ABC's federal Schedule M-1, which records book-to-tax differences. Tr. pp. 111-12 (Doe). Doe, however, was unable to identify which specific book item or items whose change between the first and third quarters of 1998 caused his calculation of ABC's federal taxable income from a plus \$5.3 million to a negative \$8.7 million, or caused his calculation of ABC's net Illinois income to change from a plus \$4.3 million to a negative \$13.5 million. Tr. pp. 110-112, 132 (Doe); *compare id.* pp. 96-97 (Doe, describing his estimates of ABC's 1997 federal taxable and Illinois apportionable net income during late February 1998) *with* Stip. Ex. 4, p. 1 (Part I, lines 1, 7).
26. After he calculated the amounts of each of ABC's 1998 second, third and fourth quarter estimated tax payments, Doe communicated what those payments should be to Jim Doe ("Jim Doe"), ABC's manager of corporate finance during 1998. Tr. pp. 20-21, 35 (Jim Doe), 113-115 (Doe).

27. Jim Doe's duties for ABC included, in part, providing liquidity to the corporation, cash management and asset and balance sheet management. Tr. p. 21 (Jim Doe). He also was responsible for making timely payments of ABC's estimated tax payments to relevant jurisdictions. *Id.*
28. Jim Doe typically received a telephone call from Doe approximately one to two weeks prior to the date an estimated tax payment was due, during which call Doe would inform Jim Doe of his rough estimate of ABC's estimated tax payment. Tr. p. 21 (Jim Doe). Jim Doe would then arrange to have available any funds necessary to make the estimated tax payment. Tr. pp. 21-22 (Jim Doe).
29. About two to three days before an estimated tax payment was due, Doe would send his worksheets to Jim Doe by facsimile, showing the amount of ABC estimated payment to Illinois. Tr. p. 22 (Jim Doe).
30. Depending on the type of payment required, Jim Doe would either arrange to have a ABC check prepared in the amount of the estimated tax payment, and made payable to the pertinent jurisdiction, or he would arrange to have an electronic wire transfer effected. Tr. p. 22 (Jim Doe). Where a check was used to pay ABC's Illinois estimated tax for the second and third quarters of 1998, Jim Doe signed it and secured a necessary second signature. Tr. pp. 22-23 (Jim Doe); Stip. Exs. 9, 11 (copies of ABC checks drawn to pay its 1998 second and third quarter Illinois estimated tax installments).
31. Jim Doe knew that quarterly estimated tax payments were time sensitive, that is, that they had to be mailed on or before certain dates of the year. Tr. pp. 23, 36 (Jim Doe). He also knew that proof of timely mailing was ordinarily shown where the envelope in which a quarterly estimated tax payment was mailed bore a U.S. Postal Service stamp that was dated on or before the payment's due date. Tr. p. 23 (Jim Doe).
32. The envelope in which ABC's check drawn to pay its third quarter Illinois estimated tax payment for 1998 was actually delivered to the Department was not mailed on or before the due date of the payment. Tr. pp. 44-46 (Jim Doe).

Conclusions of Law:

When the Department introduced the notice (Stip. Ex. 5, pp. 7-8) and denial (Stip. Ex. 2) it issued to

ABC into evidence, it presented prima facie proof that ABC was liable for the penalties at issue. 35 **ILCS** 735/3-3(f); 35 **ILCS** 5/904(a). The Department's prima facie case is a rebuttable presumption. Branson v. Department of Revenue, 68 Ill. 2d 247, 261, 659 N.E.2d 961, 968 (1995). A taxpayer cannot overcome the presumption merely by denying the accuracy of the Department's assessment, or merely by denying knowledge of a tax deficiency. Branson, 68 Ill. 2d at 267, 659 N.E.2d at 971; A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833, 527 N.E.2d 1048, 1053 (1st Dist. 1988). Instead, a taxpayer is obliged to present documentary evidence that is consistent, probable and closely identified with its books and records, to show that the assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); PPG Industries, Inc. v. Department of Revenue, 328 Ill. App. 3d 16, 33-34, 765 N.E.2d 34, 48-49 (1st Dist. 2002).

Section 804(a) of the IITA provides that “[i]n case of any underpayment of tax by a taxpayer, ... the taxpayer shall be liable to a penalty in an amount determined at the rate prescribed by Section 3-3 of the Uniform Penalty and Interest Act upon the amount of the underpayment (determined under subsection (b)) for each required installment.” 35 **ILCS** 5/804(a). For a corporation, the penalty shall not apply if it was not required to file an Illinois income tax return for the preceding taxable year, or if the underpayment was due solely to the change in the taxpayer's apportionment method required by § 304(h). 35 **ILCS** 5/804(a), (d). Also, the penalty “... shall not be imposed to the extent that the Department or his designate determines, pursuant to Section 3-8 of the Uniform Penalty and Interest Act that the penalty should not be imposed.” 35 **ILCS** 5/804(a), (e).

Section 3-8 of the UPIA provides that penalties imposed by §§ 3-3, 3-4, and 3-5 shall not apply if the taxpayer shows that its failure to file a return or pay a tax when due was due to reasonable cause. 35 **ILCS** 735/3-8. It further provides that reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department. *Id.* The Department has promulgated a regulation in which it defined reasonable cause and described how it would administer the UPIA. 86 Ill. Admin. Code § 700.400. That regulation provides, “... whether a taxpayer acted with reasonable cause shall be made on a case

by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.” 86 Ill. Admin. Code § 700.400(b); *see also* PPG Industries, Inc., 328 Ill. App. 3d at 22-23, 765 N.E.2d at 40. The regulation further provides that, “[a] taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer’s experience, knowledge, and education. ****” 86 Ill. Admin. Code § 700.400(c).

The first issue is whether reasonable cause exists to abate ABC’s underpayment of its estimated tax for the first two quarters of 1998. On this point, ABC argues that it exercised ordinary business care and prudence because it relied on its accountant’s calculations of those payments, and because its reliance was reasonable. Taxpayer’s Opening Post-Hearing Brief (“ABC’s Brief”), pp. 7-12. The Department counters that, as a matter of law, the safe harbor provision found in § 804(c)(1)(ii) cannot apply to this situation because ABC had not filed a return for 1997 when it calculated its first and second quarter estimated tax payments. The Department also argues that ABC should not escape the penalty imposed by § 804 simply by claiming that it relied on its accountant's advice, since its accountant used ABC’s own financial figures to calculate ABC’s estimated tax payments for the applicable period.

On this issue, ABC offered the testimony of Doe, the Illinois accountant who calculated ABC’s federal and state estimated tax, and that of Ron Doe, an employee and, during 1998, vice president and chief financial officer of a ABC subsidiary, who worked with Doe during the applicable period. Doe testified regarding the methods he used to calculate the amount of ABC’s estimated tax payments for the first through third quarters of 1998. *See, e.g.* Tr. pp. 87-88, 95-100, 105-112 (Doe). He received documents and verbal financial information from three sources, each concerning different aspects of ABC’s business. He received that information from Ron Doe and from two other of ABC’s outside accountants. Based on the information he received, Doe

calculated what he anticipated ABC's 1998 Illinois estimated tax payments should be. Doe also calculated ABC's federal estimated tax payments. What is clear from his testimony is that it was only when he was calculating ABC's third quarter Illinois estimated tax installment that he began to base ABC's estimated tax for 1998 on its business activities conducted during 1998. Tr. pp. 110-112 (Doe). Up to that point, Doe based his calculation of the amount of ABC's estimated tax on the amount of the net income he thought ABC had realized during 1997. Tr. pp. 87-88, 94-100 (Doe).

In that way, Doe subordinated IITA § 803's legislative intent that a taxpayer define and calculate its estimated tax based on the current year's income, to IITA § 804's provision that, in the event a taxpayer errs when calculating its estimated tax for the current year, it will not be penalized for a given quarter so long as it has paid at least one quarter of 90% of the current year's liability, or one quarter of 100% of the prior year's liability, so long as the taxpayer filed a return for a full year, and the return showed a liability for that prior year. 35 ILCS 5/803-804. The legislative intent to have a taxpayer calculate its estimated tax based on the current year's income is set forth in § 803's definition of estimated tax. That provision states, in pertinent part:

Payment of Estimated Tax.

(a) **Every taxpayer other than an estate, trust, partnership, Subchapter S corporation or farmer is required to pay estimated tax for the taxable year,** in such amount and with such forms as the Department shall prescribe, if the amount payable as estimated tax can reasonably be expected to be more than (i) \$250 for taxable years ending before December 31, 2001 and \$500 for taxable years ending on or after December 31, 2001 or (ii) \$400 for corporations.

(b) Estimated tax defined. The term "estimated tax" means the excess of:

- (1) **The amount which the taxpayer estimates to be his tax under this Act for the taxable year,** over
- (2) The amount which he estimates to be **the sum of any amounts to be withheld on account of or credited against such tax.**

35 ILCS 5/803(a)-(b) (emphasis added). The legislative intent is further reflected in § 803's requirement that estimated tax "... shall be paid [in] four equal installments ... for each taxable year, payable as follows:

Required Installment:	Due Date:
1 st	April 15
2 nd	June 15
3 rd	September 15
4 th	Individuals: January 15 of the following taxable year Corporations: December 15

35 ILCS 5/803(d).

As a financial incentive to insure that estimated tax was timely paid in equal installments throughout and shortly after the current taxable year, the General Assembly enacted, in § 804, a penalty to be assessed on the amount of any underpayment of an estimated tax installment. 35 ILCS 5/804(a). After defining underpayment (35 ILCS 5/804(b)), the legislature created “safe harbor” provisions that protect a taxpayer that makes a mistake when attempting to estimate its current year’s tax. 35 ILCS 5/804(c). The safe harbor that ABC argues that it used in 1998 is found at § 804(c)(1). Section 804(c)(1) provides:

- (c) Amount of Required Installments.
 - (1) Amount.
 - (A) In General. Except as provided in paragraph (2), the amount of any required installment shall be 25% of the required annual payment.
 - (B) Required Annual Payment. For purposes of subparagraph (A), the term “required annual payment” means the lesser of
 - (i) 90% of the tax shown on the return for the taxable year, or if no return is filed, 90% of the tax for such year, or
 - (ii) 100% of the tax shown on the return of the taxpayer for the preceding taxable year if a return showing a liability for tax was filed by the taxpayer for the preceding taxable year and such preceding year was a taxable year of 12 months.

35 ILCS 5/804(c)(1).

The legislature intended § 804’s safe harbors to create an absolute floor below which the taxpayer could not escape the imposition of the penalty. ABC could not take advantage of the first of § 804(c)(1)’s safe harbors because it did not attempt to calculate its first two estimated tax installments by reference to its 1998 income. It could not take advantage of the second because it reported a net loss on its 1997 Illinois income tax return. In fact, what ABC did here was to treat the lesser of § 804(c)(1)’s safe harbors not as a floor, but as a rough ceiling above which it could ignore the legislature’s intent that it base its estimated tax on its current year’s tax.

The interrelationship between §§ 803 and 804 of the IITA is not esoteric, complicated or obscure. Section 803 requires certain taxpayers to pay estimated tax when their net income exceeds certain levels, defines “estimated tax,” and sets the dates by which a taxpayer’s estimated tax payments are due. Section 804

imposes a penalty for a taxpayer's underpayment of its estimated tax, defines underpayment, and provides safe harbors for those taxpayers that, within certain parameters, miss the target when trying to correctly calculate and pay their estimated tax for the current year. But Doe's own testimony shows that he treated § 804(c) not as a safe harbor, but as the target. Even when he knew ABC was realizing significantly more net income in 1998 than it had during 1997, he calculated ABC's 1998 estimated tax payments by reference to what he thought was ABC's significantly lower tax liability for the prior year. Tr. pp. 105-07 (Doe). In short, Doe treated § 804(c)'s definition of "required annual installment" as though it superceded § 803(b)'s definition of "estimated tax." To continue with the nautical analogy, Doe either ignored or disregarded the legislature's express intent that a taxpayer aim for the dock, i.e., that it calculate and pay its estimated tax by reference to its income-producing activities during the current taxable year, and instead acted as though ABC need only aim for one of the outer boundaries of the harbor. Tr. p. 106 (Doe). Given Doe' misdirected focus on what ABC's estimated tax target should be, it should not surprise anyone that it ran aground.

ABC, however, argues that "[t]he question is not whether Doe or ABC reasonably relied on the safe harbor provision. The question, rather, is whether ABC reasonably relied on a long-time accountant in whom it had 'total' and 'complete' trust in determining its estimated tax payments for the first and second quarters of 1998." ABC's Brief, p. 12. ABC argues that the evidence shows that it did. *Id.*

The evidence ABC offered to show that ABC relied on Doe' figures consisted of the testimony of Ron Doe, a vice president and chief financial officer of a ABC subsidiary that headed its Community group of newspapers. In summary, Ron Doe's testimony on this point was that he had worked with Doe since 1991, that he relied on Doe to calculate ABC's estimated tax, that he never had any problems with Doe' estimates during prior years, and that he trusted him completely. Tr. pp. 149-51 (Ron Doe). When considering this testimony, I am mindful of the Department regulation's provision that whether a person acts with ordinary business care and prudence when attempting to calculate the correct amount of tax "... is dependent upon the clarity of the law or its interpretation and the taxpayer's experience, knowledge, and education. Accordingly, reliance on the advice

of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence, nor does reliance on incorrect facts such as an erroneous information return.” 86 Ill. Admin. Code § 700.400(c).

ABC is a multinational unitary business that includes 88 domestic subsidiaries and 25 foreign subsidiaries. Tr. pp. 83-84 (Doe). According to the testimony at hearing, in addition to Doe, it uses at least two other accountants to accumulate and/or compile the financial information Doe used to calculate its estimated tax. Tr. pp. 94-97, 144 (Doe). Ron Doe himself is an experienced accountant. Tr. p. 146 (Ron Doe). As a taxpayer, therefore, ABC has experienced, knowledgeable and educated employees and agents who labor on its behalf. Logic dictates, and applicable law reflects, that the greater a taxpayer’s education, knowledge and experience, the less likely that it will be ignorant of the various and sundry laws applicable to its business. *See* 86 Ill. Admin. Code § 700.400(c). Here, Ron Doe did not testify that he did not know what ABC’s Illinois’ estimated tax responsibilities were. To the contrary, he testified that he began working with Doe almost immediately upon being hired by ABC. Tr. p. 148 (Ron Doe).

Whether someone relied on another’s advice is a question of fact. U.S. v. Boyle, 469 U.S. 241, 249 n.8, 105 S.Ct. 687, 692, 83 L.Ed.2d 622 (1985) (‘Whether the elements that constitute ‘reasonable cause’ are *present* in a given situation is a question of fact, but what elements *must* be present to constitute ‘reasonable cause’ is a question of law.’) (emphasis original). The entire notion of reliance, moreover, presupposes that the person giving advice has more knowledge or ability to decide which course of action is better to take under a given set of circumstances than the one who is claiming reliance. *See, e.g.*, American Heritage Dictionary (3rd office ed. 1994) 696 (definition of “rely” is, “1. To be dependent for support, help, or supply: relies on her parents for tuition. 2. To place or have faith or confidence: relied on them to tell him the truth.”). Considering ABC’s corporate knowledge and experience, I will not presume that Doe, who was just one of ABC’s regional accountants, had more knowledge as to what IITA § 803 required than the multinational corporate client itself.

Related to this point, ABC argues in its brief that “[t]his is not a case where a taxpayer sought to justify a tax return position by hiring an outside advisor to just rubber stamp the taxpayer’s own internal research.” ABC’s Brief, p. 12. Especially when at least one case in which such facts were found to have occurred is

wending its way through the Illinois appellate court (Exxon Corp. v. Illinois Department of Revenue, No. 1-01-3302 (currently awaiting decision by the Illinois Court of Appeals, First District)), it is encouraging to hear counsel acknowledge that such situations, in fact, actually take place. But ABC offered no competent evidence to show that when Doe calculated ABC's estimated tax payments by reference to its prior year's tax instead of by reference to its current year's tax, he was acting on his own, as opposed to the way Ron Doe or others at ABC had previously directed him to calculate its Illinois estimated tax. When Ron Doe testified that he had complete confidence in Doe, for example, that only begs the question — complete confidence that he would do what? Did Ron Doe mean that he had complete confidence that Doe would accurately calculate ABC's estimated tax *by reference to ABC's current year's income*? Most decidedly not, assuming Ron Doe concurs with argument provided by ABC's counsel. *See* ABC's Brief, p. 9 (“... Doe based his calculations on all pertinent facts and circumstances and the law as it is related to those facts and circumstances. Furthermore, Doe did not base his opinion upon unreasonable factual or legal assumptions. ***”). Thus, it would be entirely consistent with the evidence that was offered at hearing to conclude that Ron Doe was confident that Doe would substitute the lower of § 804(c)(1)'s required annual payments for the estimated tax required by § 803(b), because that was what either he or someone else at ABC and Doe had agreed Doe should do.

Doe, for example, testified that he had calculated a taxpayer's Illinois estimated tax in one of two ways, either based on the current year's tax, or based on the prior year's tax. Tr. pp. 79-80 (Doe). Left unanswered, however, is why he chose to use the latter method for ABC. Was it because Doe, and Doe alone, thought it best to take that route, because ABC had directed him to do so, or because ABC agreed with Doe that that was the correct approach to take? And if, in fact, Doe *was* the one who instigated the view that § 804's definition of “required annual payment” trumps § 803's definition of “estimated tax,” did he advise ABC of the consequences of taking that filing position, just in case his assumption that ABC would have an Illinois tax liability for the prior year turned out to be wrong? If he did advise Ron Doe or someone else at ABC of the downside to that method, when did he do so? These questions are important because if ABC knew, prior to

1998, that it was rolling the dice whenever it calculated its current year's estimated tax payments by reference to its prior year's tax liability — and during those quarters when it was still unsure of what its prior year's tax liability would be — then it was most certainly *not* acting with ordinary business care and prudence.

None of the evidence offered at hearing addresses any of these questions, and where the taxpayer is not an individual but a large sophisticated taxpayer like a multinational unitary business, evidence on such points becomes more relevant and necessary.² The most important question left unanswered by the evidence ABC offered at hearing is whether ABC knew about the method Doe used to calculate ABC's estimated tax payments for the first two quarters of 1998. There are only two possibilities — ABC either knew about the methods Doe used or it did not know of them. There is nothing in this record that leads me to conclude that ABC was not aware of the way Doe calculated its Illinois estimated tax during the first two quarters of 1998. At the very least, Ron Doe never testified that Doe kept him or anyone else at ABC in the dark about how he would calculate those estimated tax payments. Again, ABC failed to introduce any credible evidence that it or Ron Doe, the chief financial officer for one of its major domestic subsidiaries, had less knowledge of what IITA § 803 required than Doe, who was just one of the regional accountants ABC used.

On the other hand, if ABC knew of the method Doe employed, and its consequences, that would at least explain why Ron Doe could testify that he had “complete confidence” in Doe, or how he could truthfully testify that Doe had performed “without incident” for ABC (Tr. p. 150 (Ron Doe)), even though Ron Doe knew, by the time he offered that testimony, that Doe underestimated ABC's first and second quarter 1998 Illinois estimated tax payments by over \$750,000 and \$1,000,000, respectively. *See* Stip. Ex. 5, p. 1 (\$5,164,713 (ABC's 1998 Illinois tax liability) \div 4 = \$1,291,178); Tr. pp. 87, 106 (Doe, describing a \$267,000 credit applied for ABC's first quarter estimated tax installment, and its \$62,000 second quarter payment). Ron Doe's professed confidence in Doe makes sense only if ABC knew about, approved of, and/or directed Doe's decision to ignore

² The reason why this is so, again, is because more is expected — and logically should be expected — of sophisticated corporate taxpayers, or taxpayers with considerably greater degrees of education, knowledge and experience,

ABC's current year's income, and instead base its Illinois estimated tax installments on the lesser of § 804(c)'s safe harbors. In that case, Ron Doe might well view ABC's first two quarterly underpayments for 1998 not so much as the result of Doe's mistake as they were the result of ABC's mistake.

On this point, moreover, I must repeat my disagreement with ABC's argument that Doe' and/or ABC's decision to subordinate § 803(b)'s definition of "estimated tax" to § 804(c)(1)'s safe harbors was objectively reasonable. *See* ABC's Brief, p. 9. The former statute sets forth the legislature's clear intent that a taxpayer pay the full amount of its current year's tax liability in equal installments, whereas the latter contains the test the legislature designed to determine whether, after the fact, someone has paid an amount of tax that, even though it does not meet § 803's definition of estimated tax, is still sufficient to avoid a § 804 penalty. 35 ILCS 5/803, 804. A taxpayer does not make a good faith effort to correctly determine a current year's estimated tax installments by ignoring the amount of income it is realizing during the current year.

I conclude that ABC has not borne its burden to show that it acted with ordinary business care and prudence by making a good faith effort to determine and pay its Illinois estimated tax for the first two quarters of 1998. I further conclude that ABC has not shown that it reasonably relied on the advice of its accountant, Doe, when it failed to make an Illinois estimated tax payment for the first quarter of 1998, and when it underpaid its estimated tax for the second quarter of 1998. During the first two quarters of 1998, rather than making a good faith effort to determine and pay its 1998 estimated tax based on the income it earned during that current taxable year, ABC calculated its 1998 estimated tax according to its anticipated 1997 Illinois tax liability. By so doing, it assumed the risk that when its 1997 Illinois return was filed in August 1998, it would not have an Illinois tax liability.

The second issue is whether ABC exercised ordinary business care and prudence when attempting to pay its third quarter estimated tax on time. The evidence regarding ABC's actions regarding the third quarter payment included the testimony of Jim Doe, a former ABC employee who prepared and signed ABC's check

than is expected of an individual taxpayer, or of an inexperienced or neophyte business taxpayer. 86 Ill. Admin. Code § 700.400(c).

drawn to pay its third quarter 1998 Illinois estimated tax payment, and the testimony of Mr. Smith, another ABC employee. Jim Doe testified that, after he received the final worksheets and payment voucher showing the amount of ABC's third quarter 1998 estimated tax payment from Doe on September 3, 1988, he drafted a check request for payment, and had his administrative assistant prepare a check and return it to him. *See* Tr. pp. 35, 54 (Jim Doe); Stip. Exs. 10-11. Jim Doe signed the check and then arranged to obtain a second required counter-signature. Tr. p. 35 (Jim Doe); Stip. Ex. 11.

Jim Doe testified that he addressed the envelope for the third quarter payment, and put the check and the voucher in it. Jim Doe said that he obtained the address he used on the envelope from the fax sent to him by Doe. Tr. p. 43 (Jim Doe); *see also* Stip. Ex. 10 (copy of the Doe fax). Jim Doe said that he then deposited the envelope into a box located in his work area at ABC, where mail to be delivered by the U.S. post office was collected by ABC employees, and then delivered to the Post Office for ultimate delivery. Tr. p. 68 (Jim Doe). Jim Doe testified that he put the payment in that box on September 14, 1998. Tr. pp. 36, 39 (Jim Doe).

Jim Doe next testified that about seven to ten days after placing the envelope in the company mail box, it was returned by the Post Office bearing a stamp that indicated that it was undeliverable due to an incorrect address. Tr. p. 39 (Jim Doe). He said that the envelope bore an incorrect address because he mistakenly typed (or wrote) the zip code as 60660 instead of 60680. Tr. pp. 39-40 (Jim Doe). Jim Doe testified that either the day he received the returned envelope or the following day, he obtained the correct address and re-mailed the check and voucher together with a letter of explanation to the Department. Tr. pp. 45-46 (Jim Doe). Jim Doe testified that he also sent a photocopy of the envelope that was stamped by the Post Office as being undeliverable with his letter of explanation to the Department. Tr. p. 73 (Jim Doe).

Finally, Jim Doe testified that he kept a copy of the letter and the original envelope returned by the Post Office in his "desk file." Tr. pp. 45, 73 (Jim Doe). Jim Doe's desk file was a collection of important documents that he maintained for reference purposes. Tr. p. 73 (Jim Doe). When Jim Doe's employment with ABC ended in May 2000, he left his desk file with ABC. Tr. p. 74 (Jim Doe).

Mr. Smith was ABC's last witness at hearing. Mr. Smith is ABC's vice-president and general counsel, and he has been employed by ABC since January 1998. Tr. p. 158 (Mr. Smith). Mr. Smith testified that the contents of Jim Doe's desk file were boxed up and are currently in storage in Toronto. Tr. p. 159 (Mr. Smith). Mr. Smith said that there was an unsuccessful attempt to locate Jim Doe's file from two rooms full of unlabeled boxes. Tr. p. 160 (Mr. Smith). Mr. Smith did not describe what that attempt entailed, who performed it, when the attempt was performed, how he knew about it, or any other particulars regarding why ABC was unable to introduce the original envelope Jim Doe testified that he mistakenly addressed to the Department, and which he said was later returned to him by the post office.

There is no dispute that the envelope in which ABC's 4.3 million (\$4,319,000) dollar check was actually delivered to the Department did not bear a U.S. Post Office stamp showing that it had been mailed on or before September 15, 1998, the date that its third quarter Illinois estimated tax installment was due. If Jim Doe's and Mr. Smith's testimonies are to be believed, ABC apparently still has Jim Doe's desk file in its possession and/or control. ABC, however, failed to introduce at hearing the original envelope that Jim Doe testified the U.S. Post Office returned to him, or a copy of that envelope. Either one of those two critical documents would have either authoritatively proved or disproved Jim Doe's testimony that ABC's payment, even though wrongly addressed, was, in fact, mailed to the Department on September 14, 1998, or on the date it was due.

In essence, ABC's evidence that the payment was timely filed consists solely of its former employee's testimony that the payment was timely mailed, as well as additional testimony offered to show why that timely mailed payment was not received by the Department. Were there some documentary corroboration of Jim Doe's testimony that he mailed the payment on or before September 15, 1998, I might agree that his explanation why the voucher and payment was not timely filed could constitute reasonable cause. That is to say, the situation Jim Doe described is similar enough to one of the examples described in the Department's reasonable cause regulation to consider it a situation akin to one where a taxpayer made an honest mistake, for example, put its state return into the federal return envelope, and vice-versa. *See* 86 Ill. Admin. Code § 700.400(e)(7). In that case, however, the agency would still be confronted with documentary evidence that corroborates the

taxpayer's testimony. That is, it would have the taxpayer's federal return in the envelope it receives. But here, ABC wants the tail to wag the dog. It wants to prove its timely filing not with the only documentary evidence that would authoritatively address the issue, but with a reasonable-sounding explanation for why the timely filed envelope never got to the destination. The evidence, in other words, presumes the very fact it is offered to establish.

This issue involves a late payment penalty. The IITA empowers the Department to review and correct errors on returns, and provides that the Department's actions regarding those returns are *prima facie* correct. 35 ILCS 5/904(a). Here, the Department issued a notice regarding ABC's 1998 return, on which it also assessed a penalty for what the parties agree was ABC's underpayment and late payment of estimated tax. Stip. Ex. 5, pp. 7-8. Just one month before the hearing in this matter began, the Illinois appellate court reaffirmed that, for Illinois income tax purposes, a taxpayer has an affirmative obligation to offer documentary evidence to support its claim that tax or a penalty is not due. PPG Industries, Inc., 328 Ill. App. 3d at 33, 765 N.E.2d at 48-49. As a matter of law, mere testimony is insufficient to rebut the Department's determination that reasonable cause does not exist (*see id.*), or that a penalty is due. Branson, 68 Ill. 2d at 261, 659 N.E.2d at 968. I must conclude, therefore, that ABC has not shown that it mailed, on or before the date it was due, a wrongly addressed envelope containing ABC's third quarter 1998 Illinois estimated tax payment. The documentary evidence admitted by stipulation in this case, moreover — the date on ABC's check (Stip., Ex. 11), and its records showing that ABC had the money available to pay its third quarter Illinois estimated tax installment (Stip. Ex. 10) — does not tend to show that Jim Doe, in fact, mailed ABC's third quarter Illinois estimated tax payment on or before the due date.

Conclusion:

I recommend that the Director finalize the Department's prior denial of ABC's claim for refund, because ABC did not exercise ordinary business care and prudence when attempting to determine and/or timely pay its estimated tax payments for the first three quarters of 1998.

Date: 10/3/2002

John E. White
Administrative Law Judge